

Chapter 5

Labor Costs

This chapter discusses:

- Labor Costs in General
- Impact of Business Structure on Labor
- Supporting Labor Costs
- Example of a Time Sheet
- Sole Proprietors' Wage Rate and Billing Rates
- Billing Rates

Labor Costs in General

Auditors look at labor costs in at least three different ways. They verify direct labor costs billed on a project, indirect labor costs accumulated in a firm's overhead rate, and total direct labor dollars used as a basis for determining a firm's overhead rate.

Auditors make the distinction between labor costs and market billing rates for services provided on an hourly basis. A billing rate includes overhead, profit, and salary while a wage or labor rate is a raw labor cost.

A firm must be able to identify direct labor, i.e., labor recorded directly to all projects, from indirect labor, i.e., that labor commonly incurred for general administration of the organization, including accounting, marketing, sales, budget, and administrative management of the organization. It should be noted that all direct labor recorded for projects goes into the direct labor base regardless of whether it is billed to the client or not.

If compensatory time for extra work or overtime pay is granted, the costs associated with this activity must be segregated from direct labor costs. The reasoning is that the fringe benefits and in part, other related overhead costs of a firm do not relate directly to the overtime hours expended while working on projects. For example, the depreciation cost of a building for a given time period is the same whether people work 40 hours per week or 60 hours per week.

Impact of Business Structure on Labor

The type of business structure may impact the development of actual labor costs, versus those that are billed. Typical business structures include sole proprietorships, partnerships, public and private corporations, and government agencies.

Under most circumstances, an employee is hired at a wage rate or salary level that is used in determining a labor rate. WSDOT uses 2,080 hours as the number of hours in a year for computing hourly labor rates. If a firm is using a standard work week of less than 40 hours, they must be prepared to show that their timekeeping and billing are based on their standard.

Supporting Labor Costs

Labor costs need to be supported by monthly, weekly, or daily time sheets for project people (those charging direct to a job) and may also be used for administrative or indirect type labor employees.

Example of a Time Sheet

In the example shown below, a firm would bill, and the WSDOT auditor would expect to see 37 hours charged to WSDOT and 18 hours of work charged to XYZ Co. for services provided.

Time sheets must be retained for at least three years after final project payment to the consultant. If in this example, the time sheet is for a subconsultant who completed work two years before the prime was paid for all work performed, the subconsultant would have to retain the time slip for at least five years.

The method for recovering vacation, sick leave, administrative time, and overtime will be discussed in the Overhead section of this guide.

Name: <u>Smith, John</u>		SSN 123-45-6789						Period Ending 1/15/00								
Job Description	M	T	W	TH	F	S	S	M	T	W	TH	F	S	S	TOTAL	
DOT 3005		4		4	2	2			8	4	4	5	4		37	
XYZ 3007		2		2	4	4				4	2				18	
OVERTIME																
ADMIN		2		2	2					2	3				11	
VACATION			8			2									10	
SICK LEAVE												4			4	
TOTAL		8	8	8	8	8			8	8	8	8	8		80	
SIGNED <u>JOHN SMITH</u>								SUPERVISOR <u>CONWAY TWIDDY</u>								

Sole Proprietors' Wage Rate and Billing Rates

In sole proprietorships, it can be difficult to determine hourly wage rates because payroll to owners may be based on company profits and draws on those profits. Because of fluctuations in work performed and resulting billings and collections, an owner may not take any salary in a month, but then recoup in later months. In this situation, the wage rate will be calculated from total annual draws.

Sole proprietorships and partnerships should realize that WSDOT is under no obligation to subsidize operating losses by paying higher than actual wage rates. This especially should be considered when the amount of draws are being determined.

Also, since some small businesses are worked only part time, it is extremely important for the owners and employees to keep detailed time records of all direct and indirect hours worked.

Once an annual average hourly rate is determined, billing rates will be based on the calculated rate in the same manner as if the rate was a regular hourly payroll rate.

See Chapter 19 for details on determining wage rates and Chapter 20 for billing rates.

Billing Rates

Billing rates must use actual payroll rates as their base. In all WSDOT agreement types, payment for direct labor is based on actual payroll rates, by employee. Proposals may estimate total labor by using average wage rates, but billing for actual services must be based on each employees actual payroll rate.

A billing rate, such as used in a provisional or negotiated hourly rate agreement, has three components:

- Direct labor
- Overhead (as a percentage of direct labor)
- Fee (either a fixed amount or a percentage of direct labor)

These and other labor billing rates are discussed further in Chapter 20.

9:P65:DP/AG

